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ABSTRACT

Two case studies of states that illustrate innovations in higher education budgeting are presented, based on a project of the Education Commission of the States. The two states, Colorado and Minnesota, took different approaches. In Colorado, the impetus for change came from key legislative members interested in providing greater autonomy to the higher education governing boards. Five key conditions provided the impetus for change: legislative leadership, governing board readiness, fiscal austerity, the presence of a mediator, and the success of more modest changes. The governing boards were given greater financial autonomy and responsibility for conducting their own business affairs. In Minnesota, the state coordinating board realized that the incremental approach appropriate in a growth environment was not well suited to an era of fiscal constraint. The board initiated a study of new approaches to budgeting and tapped a reservoir of support in the governor's office, legislature, and among the institutions. The results in both cases were similar: greater decision-making authority for those with more direct responsibility for running the institutions. (SW)

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Theoretical Perspectives on Budget Reform

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March 1984

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Annual Meeting—March 12-14, 1984—Conrad Hilton
Chicago, Illinois

Theoretical Perspectives on Budget Reform

Introduction

My assignment today is to report on a project of the Education Commission of the States that seeks to identify and analyze innovations in higher education budgeting, particularly those aimed at providing greater managerial flexibility in the use of scarce public resources.[1] A companion project, under the direction of John Folger at Vanderbilt University, focuses on budgeting for quality. Both projects are funded by the Fund for the Improvement of Postsecondary Education (FIPSE). One goal of the joint projects is to highlight innovative practices around the country and bring them to the attention of the state level policymakers in the form of a catalog that will be simple to read, brief in its descriptions, and list contact points for getting more detailed information. Through this device we hope to speed up the dissemination of new ideas and save time and effort for busy policy leaders.

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1. My firm, Augenblick, Van de Water & Associates (AVA), is completing the work on this project through a sub-contract with ECS.

Theoretical Perspectives

While not designed to support or disprove any theoretical position, this work is compatible with what Richard Elmore calls the programmatic view of policy implementation.[2] Elmore argues that in a programmatic approach the focus is ". . . on delegated control instead of hierarchical control," and the important issue is not compliance but the capacity to deliver a service.[3] Translated to the budget process, we could all cite numerous horror stories about the bureaucratic bungling resulting from state level regulations and controls designed to produce compliance (for example, pre-audits, line item controls, hiring lists, purchasing restrictions and the like). The complexity of such controls - blizzards of paper, layers of sign-offs, and unwarranted delays in decisions - absorbs substantial resources and diverts attention from the real work of a university.

> "Professor Elmore presents the thesis that the traditional attempts to control the system from the top down may well be part of the problem. . . . He maintains that influence can come only if policymakers recognize that the most important part of implementation takes place at the bottom of the system, not at the top. The more control exerted at the top, the less likely the desired results at the bottom, where the client is."[4]

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2. Richard F. Elmore, Complexity and Control: What Legislators and Administrators Can Do About Implementing Public Policy, National Institute of Education, 1980.

3. Ibid., p. 7

4. Ibid., p. v.

Washington State Senator James A. McDermott, impressed with Elmore's argument, concludes, "Policymakers may well need to recognize the limits of control they have over the system and delegate more of that control to the people delivering the services."[5]

In this case the system is public higher education, the people providing the services are institutional faculty and administrators, and the instrument of control is the budget. As we gathered case material for this project, it became clear that many state level policymakers were not only interested in the kind of approach Dick Elmore espouses but were in fact taking concrete steps to change the way budgeting is carried out by pushing decision making authority down closer to the user level.

This is, incidentally, not a new idea. My favorite advocate of this approach in the business world is Robert Townsend, who writes: "All decisions should be made as low as possible in the organization. The Charge of the Light Brigade was ordered by an officer who wasn't there looking at the territory."[6]

This morning I want to share with you two cases where states have recently moved in this direction. The two states, Colorado and Minnesota, took different approaches. In Colorado, the impetus for change came from key legislative members interested in providing greater autonomy to the higher education governing boards. In Minnesota, the state coordinating board

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5. Ibid., p. vi.

6. Robert Townsend, Up the Organization, 1970, p. 27.

realized that the incremental approach appropriate in a growth environment was not well suited to an era of fiscal constraint. The board initiated a study of new approaches to budgeting and tapped a reservoir of support in the governor's office, legislature, and among the institutions. The results in both cases were similar - greater decision making authority for the those with more direct responsibility for running the institutions.

The Colorado Case[7]

Colorado, once a state with considerable detailed budgetary control by the legislature, has become, through action of the legislature's Joint Budget Committee, a state that provides extensive fiscal autonomy to public higher education governing boards. This case is a good example of a mixed strategy that leans toward the free market approach.

The Problem

Until three or four years ago, Colorado legislative involvement in determining the details of the state appropriation for higher education had been high. Almost a decade ago, the legislature disapproved certain actions by institution presidents and attempted, primarily through the efforts of one

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7. Condensed from "Providing Public Colleges and Universities More Fiscal Autonomy: The Experience in Colorado" by William Hyde, Education Commission of the States, March 1983.

legislator, to gain increasing control of the institutions by specifying in more detail budget line items and by placing constraints on how and when state funds were to be spent. These provisions were incorporated into the appropriations act. By fiscal 1981-82, the Act specified some 53 line items in the budget for campuses; general funds reverted to the state at the end of the year; savings were subject to rescission; no institutional governing board had authority to transfer funds among line items without specific approval. The Joint Budget Committee (JBC), the legislative body in Colorado that deals with most budget issues including public higher education finance issues, set tuition rates and imposed enrollment limitations on the state's three largest universities.

Under these provisions, the governing boards had little flexibility to meet unexpected conditions or changing costs. If utility costs, for example, increased inordinately the recourse was to seek a supplemental appropriation. Similarly, supplemental funds for unanticipated enrollment increases could be requested.

The Impetus for Change

FIVE ~~Four~~ key conditions provided the impetus for change. These are described below.

1. Legislative Leadership. Two members of the Joint Budget Committee wanted the governing boards to have greater control over academic and fiscal decisions of how the colleges and universities would operate. The

legislators felt that students, choosing to attend the institution that best met their needs for the price, would exert pressure on the institutions to enhance quality and to offer appropriate programs if the governing boards were granted authority to make whatever changes seemed necessary.

2. Governing Board Readiness. The adage that there is nothing like adversity to form harmony within a group applies to the Colorado situation. The history of detailed legislative decision making combined with a new era of fiscal retrenchment led to a widespread feeling that Colorado's institutions of higher education could cope better with reduced resources if they were given greater management flexibility.

3. Fiscal Austerity. Colorado higher education was receiving smaller appropriations increases than inflation, and there was little prospect of any change.

4. The Presence of a Mediator. The governing boards needed a single spokesperson to present their views to the legislature and the Joint Budget Committee needed someone who could monitor the situation and report on its progress. The Colorado Commission on Higher Education (CCHE) served as a bridging agent between the two. Given the extended and delicate nature of the negotiations it is unlikely that basic changes would have been made without the efforts of the CCHE.

5. The Success of More Modest Changes. To the casual observer, it appears that Colorado abruptly switched from being a state that imposed strict budgetary controls on public higher education to one that provided extreme

autonomy. The transition was not as abrupt as it appears. Small but significant previous changes reflected a changing attitude that presaged the basic shift toward greater autonomy. For example, three years earlier the Consortium of State Colleges was given permission to transfer funds from one campus to another. One year earlier, in a pilot test, Pikes Peak Community College was granted permission to transfer funds among line items without legislative approval. In addition, the Colorado School of Mines received permission to modify its tuition policies.

The Change

After extended negotiations the JBC and the institution governing boards agreed to a basic shift in the way public higher education is financed in Colorado. Through a Memorandum of Understanding (MOU) to be approved each year, detailed legislative controls have been replaced with a delegation of autonomy to the institution governing boards. The first two MOUs (for FY81-82 and FY82-83) have provided four key changes:

1. Each governing board has the authority and responsibility for setting the expenditure level at each institution under its jurisdiction. State appropriations are based on general fund support per resident FTE student.

2. The number of line items for each campus has been reduced to one (except for the Health Sciences Center of the University of Colorado which has been reduced from 53 to 5). Each governing board has authority to transfer funds among institutions under its jurisdiction, and within an institution

transfers may be made among campuses, as well as programs and activities.

3. Each governing board is responsible for establishing its tuition policy although it must comply with a JBC provision that the rate for non-resident tuition be at least three times the rate for resident student tuition.

4. Each governing board is able to retain, expend and roll-forward all cash revenues generated within their institutions.

The purpose of the JBC in providing the four key changes was to give the governing boards greater financial autonomy and responsibility for conducting their own business affairs. The changes constitute a fundamental alteration of the way public colleges and universities in Colorado do business and view their future. It is having a strong influence on the success of institutions in addressing issues of quality, access and efficiency.

The Results

In general terms, the greatest impact of the MOU for Colorado public higher education is the greater managerial flexibility that governing boards and institutions now have. Governing board and institutional budget planning and programmatic planning are more viable and credible. Previously, many budgeting practices were undertaken to circumvent or to comply with various budget restrictions which many institutional staff members thought were inherently unnecessary. Freed from these restrictions, budget, finance, and planning officers are able to use budget information as it is meant to be

used -- to identify where costs are actually occurring within an institution to assist in planning. Administration officials and faculty especially have greater faith in the accuracy of the budget information and believe that the linkage between academic and programmatic planning and financial planning has been improved within the institution. In addition, faculty and members of governing boards, two groups that have had little involvement in making budget decisions, are now giving more attention to these decisions.

The provisions encourage governing boards to reduce costs, reallocate funds and to save. Many institutional practices document the benefits of this greater flexibility: the president of a state university felt that he was able to adjust less traumatically to the governor's two percent budget rescission that occurred in the fall of 1982; a community college transferred $40,000 from its library book fund to another fund to establish an electronic equipment laboratory to meet local market needs.

The University of Colorado has made the greatest use of the provisions. Some of the changes UC has made are:

- Changes in tuition pricing policies, guided by access goals for state residents, academic objectives, demographic trends and market position and competition, have resulted in a one to two percent increase in the share of revenues generated by tuition.

- Acceleration of tuition collections yielded about a half million dollars in additional interest income. The earlier tuition collection efforts have reduced uncollectibles by about half, providing an additional half

million dollars in revenue. At the CU Health Sciences Center, the average age of receivables has been reduced from 125 days to 90 days, which also provides additional revenue. Previously, there was not an incentive to expend staff effort on these activities because realized savings would not have accrued to UC.

- Gift revenues from private sector donors doubled in the first year of operation under the MOU from the previous year largely because of the assurance the donors had that their gift funds would not supplant state funds.

- Through managerial "tight-fisted" policies of downgrading jobs and hiring at the lowest end of the pay scale UC saved another million dollars in 1981-82.

UC has instituted several programs and practices to improve the educational enterprise:

- A contingency fund, equaling about 0.8 percent of total expenditures, is established at the beginning of each year at each campus to be used for such things as unusually high utility costs, tax revenue shortfalls, adverse flow of federal grants or extraordinary needs for student financial aid funds. The contingency fund mitigates the impact of these unexpected costs on academic programs.

- With autonomy to set its own tuition rate UC has established a new executive MBA program that is self-funded.

- If excess revenues are realized, 20 percent are retained by the president and 80 percent by the campus chancellor. Within the campus, 20 percent is retained by the chancellor and 80 percent by the unit responsible for the savings. In 1981-82 the president invested his funds in academic improvements by establishing five $15,000 research grants for young, promising faculty members who are at a disadvantage in obtaining their own research funds. He also established ten $1,000 awards for excellence in teaching. In addition, UC has turned around the downward trend in faculty salaries and library support. It now funds them near the median of its peer institutions.

Other governing boards and institutions, given the same autonomy through the MOU as UC, have benefited from many of the same types of changes.

The Minnesota Case

An excellent example of a planned approach to the policy issues of the Eighties is the Minnesota case described below.

The Problem

By 1979 Minnesotans were realizing that revenue constraints and projected enrollment declines made it necessary to re-examine the funding practices that had served well during times of expansion.

The funding system used by the legislature in the 1970's was essentially an incremental approach in which last year's base was largely accepted and requests for expansion or addition of activities were closely scrutinized. The major factors in budget decisions had been increasing enrollments supported by an expanding state revenue base. Anticipating enrollment declines after the early 1980's the legislature, in 1977, decided to freeze basic appropriations at 1977 levels and treat short term enrollment increases on an exception basis with funds provided by increased tuition revenues, and later by partial state support.[8]

During the period 1977-1983, enrollments in all sectors grew but not at the same pace. At the University of Minnesota, enrollments grew by 2.5%, while the state universities grew 12% and community colleges increased 22%. Area vocational technical institutes (AVTIs), run by local school districts, grew 17%. In the early Eighties, reductions in state appropriations for postsecondary education resulted in state funding below the 1977 freeze levels. The net result was that tuition was increasing both in amount and as a percentage of instructional expenditures; and state appropriations for instruction (in constant dollars) were declining. State leaders feared that tuition increases would restrict access to higher education for Minnesota residents and that the quality of education would suffer if instructional support continued to decline.

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8. For a more detailed explanation of these policies see the Final Report of the Task Force on the Future Funding of Postsecondary Education. Minn HECB, Dec 1982, Part II.

The Impetus for Change

The ad hoc accumulation of a variety of mechanisms for funding the state's 63 public institutions of higher education during a period of growth was not adequate to the task of funding these same institutions during a period of decline. Projected enrollment declines and the first tastes of state fiscal constraints moved the Higher Education Coordinating Board (HECB) to raise long term funding issues at its 1979 annual meeting of governing boards. This airing of the issues plus support from the governor led to the formation of a Task Force to "assess the implications of continuing existing funding policies and implications of alternative funding policies, including those alternatives which recognize fixed and variable cost behavior."[9]

In December 1982, the Task Force issued its report, including an evaluation of current and alternative funding policies and a series of findings leading to seven recommendations, including the establishment of a 1% fund to encourage improvements in quality and productivity, the adoption of a comprehensive cost-related tuition policy, greater responsibility for governing boards, and the implementation of average cost funding.

The Task Force's recommendations were adopted by the HECB and found ready support from the new governor who viewed improving education as a long term commitment that would support economic development and job creation.

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9. From the charge to the Task Force On the Future Funding of Post-Secondary Education, May 1980.

The governor, along with his finance commissioner, also favored policy approaches that emphasized market responsiveness. The recommendations forwarded by the HECB supported these preferences and were therefore incorporated into the governor's FY83-85 biennial budget request along with recommendations for sweeping changes in the state's system of providing student financial aid. The governor's integrated package of higher education policies contained five recommendations that together comprised a plan for Minnesota postsecondary education designed to preserve quality during a period of enrollment decline and government cutbacks. These recommendations, with some modifications, were approved by the Minnesota legislature during the 1983 session.

The Changes

Legislative approval of the higher education policy changes proposed by the governor culminated a lengthy process designed to produce a carefully thought out, conscious change in policy direction. The process itself is of interest because it was deliberate, focused, and successful. In this section, however, the spotlight is on the changes.

Three of the four major changes were designed to provide equity and access in financing. The fourth provided more authority for the four governing boards to manage resources with the intent of fostering priority setting and protecting quality.

In place of the hodge podge of state financing approaches with its

attendant special interest preferences, the basic funding strategy for all public institutions begins with average cost funding. In essence this approach provides each public system with basic support that is related to ~~how much it costs to~~ the average cost of instruction. Since costs vary by program (e.g., the physical sciences, humanities), and level (e.g. lower division, upper division, graduate, professional), and these mixes vary from institution to institution, the overall average cost for a system will reflect its particular mix and will not be the same as its neighbors. Average cost funding is closely tied to enrollments. The amount of state support is calculated as the product of the average cost times full year equivalent enrollment minus tuition revenue. Because Minnesota expects significant enrollment declines (22-24% over the next 10 years), the enrollment figure used in the calculation is two years earlier than the year being funded. This two year lag slows both the addition and withdrawal of public funds caused by enrollment changes. In this way it provides extra time for those institutions experiencing enrollment declines to adjust to changing conditions. Although the two year lag slows the withdrawal of funds, the fact that funding decreases are based on <u>average</u> costs means that funding decreases can be expected to exceed declines in actual costs (which will decrease at lesser marginal rates). Institutions continuing to show enrollment growth will be expected to fund the additional marginal costs through increased tuition revenues.

The second major change, tuition policy, is related to average cost funding through use of instructional costs as the key factor in setting tuition levels. As a public policy Minnesotans have agreed that tuition

revenue should equal 35% of instructional costs in the three public collegiate systems (University of Minnesota, state universities, community colleges) and 25% of instructional costs in the area vocational technical institutes (AVTIs). Because of existing differences in tuition levels, a phased approach will be used to achieve this policy goal over the next three years. When completed tuition levels will have risen substantially, exceeding 70% at the AVTIs, about 50% at the state universities, and roughly 25% at the University of Minnesota. Agreement was not unanimous, however, as student groups and faculty from the State University System opposed tuition increases.

To protect access for low income students substantial increases in state student financial aid are planned and student aid policies have been revamped. Under the new Design for Shared Responsibility, "...all applicants, as the primary beneficiaries of the education, will be expected to contribute at least 50 percent of their cost of attendance from savings, earnings, loans, or other additional assistance from institutional or private sources. The remaining cost will be met by a contribution from parents determined by a national need analysis and by the combination of federal Pell Grant and State Scholarship and Grant awards."[10] While the new policy applies to Minnesota residents attending both public and private higher education institutions in the state, caps have been placed on the amount of costs the state will recognize thus effectively controlling the size of the grant that may be made to a poor student attending a high cost private

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10. Mhecb report, Vol. VI, No 12 (July 1983), p 8.

college. Even with this provision, however, faculty in the State University system opposed the increase in grants for students attending private colleges and universities.

Finally, in a conscious effort to improve the management flexibility provided to all public sector higher education institutions, the legislature approved giving the State University Board and the State Board for Community Colleges the same authority as the Board of Regents of the University of Minnesota and the newly created independent State Board for Vocational Technical Education that governs the AVTIs. The extended authority includes the ability to close institutions under their jurisdiction, carry over funds from the first year of the biennium and carry up to 2% of their appropriation from biennium to biennium. None of these carry forward funds are to be taken into account when appropriations are made.

The Results

Too little time has elapsed to know if these moves - designed to continue access, improve equity, and protect quality - will produce the intended results. It is generally agreed, however, that the incentives are in place for governing boards and senior administrators to make the critical decisions necessary to shape the institutions under their control in response to the education needs of the Eighties and beyond. Education leaders in each of the sectors support the new system. Its major strength is that the four public systems are now treated in the same manner for funding purposes and

the allocation of public resources can now be made more reasonably and understandably.

The University of Minnesota is pleased because they had argued for many years that costs varied by level and type of program and the new approach recognizes this. In addition, university students had been bearing a higher proportion of instructional costs; the new system results in a more equitable tuition pricing policy for all students.

The State University System has supported the changes, primarily because of the increases in state support that result, but is concerned about the possible long term effects of tuition increases on enrollment levels. Part of this concern relates to the financial burden on middle class residents. Despite increases in student aid funds, system administrators expect that a public undergraduate education will be increasingly difficult for middle class families to afford. They will be monitoring enrollment levels carefully to see if such a trend develops.

The community colleges favored average cost funding approach with the two year enrollment lag because it gives them time to adjust to changes. Even though some institutions expect enrollment increases, there is not a large concern about the lag in state support when enrollments increase since community colleges have lived with funding increases that have not kept pace with enrollment growth for several years. As one official pointed out, it is an improvement to know that the funding approach will produce additional support even if it is two years later.

Despite enrollment increases annually for the last three decades, the area vocational technical schools expect enrollment declines in the late Eighties. They agree with the policy changes and are not as concerned about access as the state university system is. Although tuition will have gone from zero to almost $1000 per year next year, student aid for vocational technical students increased from about $600,000 to $50 million. With roughly 80% of their students receiving some kind of student aid, system administrators feel that access has improved over the last five years.

While it is expected that refinements to the new funding policies will be debated over the next few years, the basic approach appears to have widespread support and is unlikely to be challenged. Refinements are likely to center on improved means of identifying average costs, for example, more accurate average cost multipliers and possibly changing the base year.

To be successful, the legislature's move to give more decision-making authority to the sector governing bodies will require the exercise of considerable restraint on the part of individual legislators. Whether or not legislators are willing to allow a governing board to close a campus or even a program remains to be seen. The first test of restraint is likely to come from the new Board for Vocational Technical Education which is preparing to exercise its authority to close inefficient or underenrolled programs at area vocational technical institutes.

One area that was not specifically addressed during this reexamination of public policy was continued planning for postsecondary education. Issues like refinement of role and mission statements for the various sectors,

program review and evaluation, and the role of the Higher Education Coordinating Board are likely to be on the agenda for the next few years. A governor's commission on the future of higher education is currently addressing these issues.

Another area not specifically addressed was state controls over personnel and purchasing. Except for the University of Minnesota, higher education institutions currently are required to use central state purchasing services and the state's civil service system for support personnel. With the greater autonomy given to governing boards it would seem reasonable to extend their management flexibility to these areas as well.

Conclusion

The funding and governance of higher education in Minnesota has undergone significant change as a result of common agreement on the need for change and the willingness of all sectors to work together to produce change. The careful preparation of background materials, the broadly participatory approach, the strong support of the governor and finance commissioner, the consensus among education leaders, and astute legislative leadership combined to produce a series of changes that are universally regarded as good for higher education in Minnesota. While it is too early to judge if this will turn out to be the case, there is currently a widely held expectation that Minnesota higher education will be better able to weather the storms ahead because of these efforts.

Other Examples

These are not isolated instances. Other examples include:

- KENTUCKY: tying budget decisions more closely to institutional missions and providing greater financial flexibility to institutions.

- CONNECTICUT: changing to a program based budget and experimenting with allowing institutions to retain tuition receipts.

- MASSACHUSETTS: changed to a unitary budget prepared by the Board of Regents and featuring fewer budget categories and greater flexibility.

- NORTH DAKOTA: relaxed controls on shifting funds from one budget category to another; discussing linking tuition to cost of instruction; undertaking a study of alternative funding models.

- SOUTH CAROLINA: undertaking a study of overall budgeting processes for higher education.

- WISCONSIN: delegated authority to the University in the areas of general purchasing, printing, computer acquisitions, telecommunications, and employee classifications.

Conclusion

Washington State Senator James A. McDermott expresses the legislators

feelings well when he writes:

> Legislators are bedeviled by the realization that too few people benefit from the social legislation designed to help them. . . . Frustration at failure to achieve desired results leads legislators to propose legislative vetoes and to demand that departments tighten the screw by writing tougher regulations and providing more surveillance.[11]

As illustrated in the examples above, more and more policy leaders are becoming disenchanted with this approach and looking for a more productive means of achieving policy goals. I see this as a healthy development for higher education because it places responsibility closer to the real problem-solvers - people on the firing line trying to do a better job.

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11. Richard Elmore, Complexity and Control: What Legislators and Administrators Can Do About Implementing Public Policy, National Institute of Education, 1980, p. v.

ABOUT AVA

Augenblick, Van de Water & Associates (AVA) is an independent consulting firm specializing in education policy and planning services. Its purpose is to help education and political leaders examine today's complex education issues and find appropriate solutions.

AVA focuses on issues related to financing, governance of and planning for elementary/secondary and postsecondary education.

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